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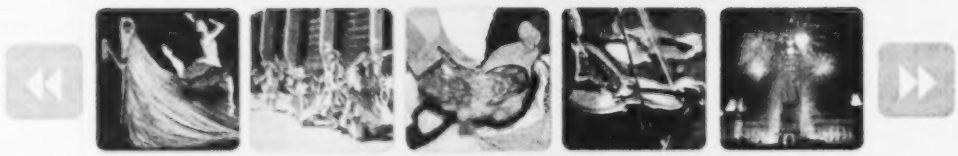
Canada

Internal Audit of the Grants and Contributions Processes – Horizontal Audit

Office of the Chief Audit and Evaluation Executive
Audit and Assurance Services Directorate

February 2009



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Executive Summary

Introduction

There are currently over 40 grants and contributions (Gs and Cs) programs with 45 different components administered by the Department of Canadian Heritage (PCH). This category of expenditures accounts for approximately $1.15B out of a total budget of $1.4 B (or 82%). It is supported by 2,300 employees within Headquarters and Regions. Each year, nearly 8,700 contributions or grants are approved for funding. Transfer payments (using Gs and Cs) are PCH's primary means of achieving its policy objectives.

In ensuring the effectiveness of PCH's Gs and Cs business processes, PCH management have implemented core Gs and Cs internal controls, many of which are standardized and have been implemented in multiple PCH programs. Similarly, core controls have been implemented within PCH central functions, namely the Centre of Expertise (CoE) and the Accounting Operations and Financial Policies Directorate. In this audit, the Gs and Cs core controls have been categorized in accordance with the Gs and Cs life cycle, as presented in the Canadian Heritage Grants and Contributions Management Policy.

These core Gs and Cs controls are intended to be the minimum set of safeguards that help support the achievement of objectives by managing the level of risk inherent in the Gs and Cs business processes in each phase of the life cycle.

As the responsibility for core controls used within Gs and Cs programs is distributed between program management in all PCH sectors and management within central functions, the scope of this audit focused only on internal controls, risk management, and governance processes under the responsibility of the two key centralized functions: Gs and Cs Centre of Expertise and Accounting Operations and Financial Policies Directorate. The time period covered by the audit was April 1, 2006 to March 31, 2008. The objective of this audit engagement was to provide PCH management with assurance of the existence and effectiveness of the core Gs and Cs controls that include the responsibility of management in centralized functions of the Gs and Cs CoE and the Accounting Operations and Financial Policies Directorate.

Key Findings

The audit revealed that five of the nine controls, including key high risk areas (e.g. financial payments, segregation of duties), are properly designed and being applied effectively within PCH central functions. This resulted in several positive findings such as:

- Based on the samples selected in this audit, financial controls in the areas of payment approvals, recording of payments, detection of over/under payments, and segregation of duties are well controlled by central functions;

- The PCH CoE existence is considered to be a best practice and plays a critical role in providing guidance and on-going supervisory review and compliance monitoring in the Gs and Cs process;

- The enhanced monitoring activity performed by the CoE, Advisory Services has assisted in improving the performance and in strengthening controls through its enhanced monitoring of eligibility assessments performed by program management;

- The documentation of controls, process narratives and mappings, and control matrices which have been developed in preparation for departmental audited financial statement audits will help to further strengthen and improve core Gs and Cs controls.

Recommendations

The following recommendations address issues where there are opportunities for strengthening controls.

Here are the recommendations:

1. The Director General, Financial Management Branch, should formally establish service delivery standards, including supporting analysis to demonstrate that standards meet management expectations and have been set with appropriate client input, rationale and support (e.g. benchmarking). These service delivery standards should be communicated to program management to assist in planning processes and procedures accordingly; and the CoE should actively monitor adherence to these service delivery standards.

2. The Director General, Financial Management Branch, should conduct an analysis to establish a target for an acceptable number of gaps identified through its enhanced monitoring and monitor program performance relative to this target.

3. The Director General, Financial Management Branch, should establish a formal procedure or process to ensure on-going monitoring of user security permissions for GCIMS access, appropriate user access, and enforce the requirement that all GCIMS accounts be uniquely identifiable.

4. The Director General, Financial Management Branch, should, in selecting payments for analysis, make use of a statistical approach that allows for more extensive examination of high risk payments.

Statement of Assurance

In my professional judgment as Chief Audit and Evaluation Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the opinion provided and contained in this report. The opinion is based on a comparison of the conditions, as they existed at the time, against pre-established audit criteria that were agreed to with management. The opinion is applicable only to the entity examined and within the scope described herein. The evidence was gathered in compliance with Treasury Board policy, directives, and standards on internal audit and the procedures used meet the professional standards of the Institute of Internal Auditors. Sufficient evidence was gathered to provide senior management with the proof of the opinion derived from the internal audit.

Audit Opinion

In my opinion, the controls within central functions for the Gs and Cs Processes are well controlled with minor improvements needed in the area of stewardship.

Original signed by:

Vincent DaLuz
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Audit Team Members

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With the assistance of external resources

1. Introduction and Context

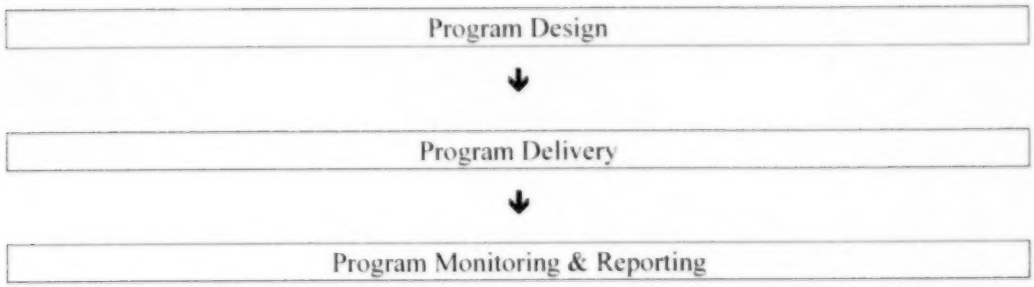
1.1 Authority for the project

The 2007-08 Risk-based Audit Plan of the Audit and Assurance Services Directorate, Office of the Chief Audit and Evaluation Executive (OCAEE), identified the requirement to conduct an internal audit of grants and contributions (Gs and Cs) throughout the Department and to document and test Gs and Cs internal controls.

1.2 Background

There are currently over 40 Gs and Cs programs with 45 components administered by PCH. This category of expenditures accounts for approximately $1.15B out of a total budget of $1.4 B (or 82%). It is supported by 2,300 employees within Headquarters and Regions. Each year, nearly 8,700 contributions or grants are approved for funding. Transfer payments (using Gs and Cs) are PCH's primary means of achieving its policy objectives.

PCH has defined a control framework for its Gs and Cs processes that is consistent with the PCH Gs and Cs lifecycle (i.e. Program Design, Program Delivery, and Monitoring), presented in the Canadian Heritage Grants and Contributions Management Policy, as follows:



For each Gs and Cs process, a set of core controls was defined, which is intended to be a minimum set of safeguards that help support the achievement of objectives by managing the level of risk inherent in the Gs and Cs business processes in each phase of the life cycle. In total, 33 core Gs and Cs controls have been defined.

In order to validate the list of core Gs and Cs controls and solicit management input on their operating effectiveness, a control self-assessment (CSA) workshop was arranged on February 1, 2008 at the PCH Gs and Cs conference. In this CSA workshop, representative managers from a majority of the 40 PCH programs were presented a description of the process and based on their Gs and Cs programs, provided a self-assessment of how each control activity is being performed in their area. The results of this CSA workshop will be used as input in future PCH audit planning activities.

The responsibility for implementing these core controls is distributed between management in Gs and Cs programs and management within central functions (e.g. CoE, Finance); however, as Gs and Cs programs are distributed widely in all PCH sectors, a majority of these core controls are the responsibility of program management. As such, management within PCH central functions are responsible for only 9 of the 33 core controls. These nine central core controls and the functions responsible for implementing these central core controls were the focus of this audit.

It should be noted that the other core Gs and Cs controls, which are the responsibility of program management, will be audited through other risk-based Gs and Cs program audits.

Within the Financial Management Branch (FMB) of PCH, a number of groups play a critical role in ensuring the effective delivery of PCH's Gs and Cs business processes. A listing of these groups as well as a brief description of the relevant activities performed follows:

Accounting Operations, Financial Policy & Systems:

- Accounting Operations and Financial Policies – performs Section 33 authorization under the Financial Administration Act on Gs and Cs payment requests made by Programs and processes Gs and Cs payments; and,
- Financial Systems – provides on-going support and maintenance of PCH's central financial system (SAP), user profiles and master data (vendor, customers, fund centers).

Centre of Expertise (CoE), Grants and Contributions:

- Secretariat Services – receives files submitted by Programs on behalf of the CoE, reviews files for completeness and selects which files are transferred to Advisory Services for compliance monitoring ("i.e. enhanced monitoring");
- Advisory Services – performs compliance monitoring of documentation submitted for ministerial approval by Programs and performs a more detailed request for payment analysis when requested by Programs; and,
- Gs and Cs Information Management System (GCIMS) Services – provides on-going support and maintenance of GCIMS, user profiles, and monitors critical security permissions in GCIMS.

2. Objectives

The objective of this audit engagement was to provide PCH management with assurance of the existence and effectiveness of core Gs and Cs controls that include the responsibility of management in the centralized functions of the Gs and Cs Centre of Expertise and Accounting Operations and the Financial Policies Directorate.

3. Scope

As the responsibility for core controls used within Gs and Cs programs is distributed between program management in all PCH sectors and management within central functions, the scope of this audit focused only on internal controls, risk management, and governance processes under the responsibility of the two key centralized functions: Gs and Cs Centre of Expertise and Accounting Operations and Financial Policies Directorate. Specifically, central core controls examined in this audit are as follows:

- Internal service standards for review and approval exist and meet management's expectations;
- Internal service standards are formally communicated to program management;
- There is timely approval of all funding recommendations by the Minister or delegated authority;
- Through CoE review and compliance monitoring activities, quality assurance is maintained and Program management performance improved;
- System/manual access in key Gs and Cs systems is limited to authorized personnel;
- Potential over/under payments are detected and corrective action is taken using a risk-based approach to review payment requests;
- The vendor list is appropriately managed in order that payments are only made to approved recipients*;
- Those who approve claims do not also approve payments*; and,
- Payments are recorded accurately in SAP in the proper period*.

* The extent of the examination performed in this audit for these core controls was based on other controls-based work which had been recently performed in a process mapping exercise and on limited sample sizes.

The time period covered by the audit was April 1, 2006 to March 31, 2008.

4. Approach & Methodology

This internal audit of grants and contributions programs was conducted following the Standards for the Professional Practice of Internal Auditing as per the Institute of Internal Auditors (IIA) and in accordance with Federal Government Policy on Internal Audit.

As this audit was completed as part of a broader initiative to identify core Gs and Cs internal controls, the audit scope was designed to provide PCH management with assurance, with respect to the existence and effectiveness of core Gs and Cs controls that are the responsibility of management in centralized functions.

While the extent of the audit procedures performed during the audit examination are based on risk, the audit team placed reliance for three of the nine audit criteria on other controls-based work, such as a business process mapping exercise and program audits, which had recently been performed, rather than re-perform similar audit procedures. For

these audit criteria, evidence was primarily gathered using process walkthroughs, interviews, and limited sample sizes, as opposed to statistically based samples.

The principal audit techniques used included:

- Interviews with stakeholders and management and staff of central functions;
- Examination of supporting analysis and documentation used by management;
- Review of analysis, process mappings, and control documentation produced by central functions; and,
- Examination and testing of a limited sample of transfer payment files and payment analysis documentation to evaluate the system of internal controls within central functions.

The approach used to address the audit objectives included the development of audit criteria against which observations, assessments and conclusions were drawn. The audit criteria developed for this audit are included in Appendix A.

Audit fieldwork was conducted between February 2008 and July 2008.

5. Observations, Recommendations and Management Response

Based on a combination of the evidence gathered through documentation review, the analysis that was carried out and the interviews that were conducted, each of the audit criteria was assessed by the audit team and a conclusion for each audit criteria was determined. Where a significant difference between the audit criteria and the observed practice was found, the associated risk of the gap was evaluated and used to develop a conclusion for each audit criteria and document recommendations for future improvement initiatives.

The following recommendations address issues where there are opportunities for strengthening controls. These recommendations all relate to the Stewardship category of control criteria from the Management Accountability Framework. Details of these observations follow in this section.

5.1 Monitoring and Communication of Internal Service Delivery Standards

The audit team observed that an opportunity exists for the CoE to formalize its internal service delivery standards in the areas of expected turnaround time for the CoE's involvement in the file review process. In addition, the CoE should communicate these service delivery standards to program management and establish a process to periodically monitor central function performance against these standards.

Analysis

The audit team observed that the CoE Advisory Services, Gs and Cs Secretariat and GCIMS Services recently calculated[1] the total turnaround time for the receipt, review and approval of program files.

While the CoE has started tracking its performance, the audit team did not find established targets for internal service delivery standards for the CoE involvement in the file review process, nor did the audit team find that results were reported to program management and actively monitored or updated on a periodic basis. The audit team did not observe any analysis which demonstrated that the CoE had analyzed the turnaround times and determined their reasonableness.

The audit team is of the view that the CoE should make it a priority to formally establish reasonable turnaround time expectations and communicate these standards to program management.

Risk Assessment

When an internal service delivery standard is not established, including any analysis to determine expectations, it becomes difficult for management to determine if review and approval is indeed made in a timely fashion and how much improvement (if any) is required. When service delivery standards are not adequately communicated to program management, there is increased risk that Programs make incorrect assumptions when designing their procedures or when communicating turnaround expectations to applicants and recipients. In today's environment, where there is increased demand for improved service delivery, formal, established internal service standards are critical to successfully meet external service delivery commitments made to transfer payment applicants and recipients.

Recommendation

1. The Director General, Financial Management Branch, should formally establish service delivery standards, including supporting analysis, for the CoE's involvement in the application approval process, to demonstrate that standards meet management expectations and have been set with appropriate client input, rationale and support (e.g. benchmarking). These service delivery standards should be communicated to program management to assist in planning processes and procedures accordingly. In addition, the CoE should actively monitor adherence to these service delivery standards.

Management Response

Agreed.

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[1] Note: the GCIMS function was not audited in this audit.

5.2 Analysis of Quality Assurance Results

The audit observed that while quality assurance and compliance monitoring statistics are maintained and communicated by the CoE's Advisory Services, an opportunity for improvement exists in the analysis performed by the CoE to identify and determine possible causes for gaps (i.e. errors) and assess if risks observed through compliance monitoring have been adequately addressed.

Analysis

Currently, the CoE's Advisory Services makes use of a 20 question checklist in its enhanced monitoring to ensure that supporting documentation in a project's contribution agreement approval file is accurately completed. Staff in Advisory Services review project files and when critical deficiencies are noted, they will contact the Program for additional information before allowing the file to proceed. A database has been developed by the CoE's Advisory Services to capture enhanced monitoring statistics and the results of the enhanced monitoring are communicated and analyzed by the Programs. For the fiscal year 2006-07[2], Advisory Services reported that 18% (i.e. 60 out of 324 files reviewed) of files subjected to enhanced monitoring had at least one "important" gap (as defined by the CoE) and some project files had multiple gaps. Issues related to critical deficiencies found through enhanced monitoring have been communicated to program management.

Although the CoE, Advisory Services reported that the number of gaps is considered to be at a reasonable level and there has been improvement as compared to 3-5 years ago, no evidence of analysis was found in the audit which demonstrated that an acceptable error rate had been set with justification for what is considered to be a reasonable number of gaps. For example, no benchmarking analysis, or comparable analysis was found which could demonstrate that the number of gaps is at a desirable level and takes into account relevant factors such as account turnover and normal learning curve for staff.

In addition, no formal process was found whereby potential risks observed through compliance monitoring were examined to determine whether improvements were being made and whether those risks were being adequately addressed.

Risk Assessment

The lack of analysis to determine a reasonable number of gaps (i.e. errors) and to identify possible causes for these gaps makes it more difficult to determine how much improvement (if any) is required by central functions.

[2] At the time of the audit, analysis of data from fiscal year 2007-08 had not yet been completed.

Recommendation

2. The Director General, Financial Management Branch, should conduct an analysis to establish a target for an acceptable number of gaps identified through its enhanced monitoring and monitor program performance relative to this target.

Management Response

Agreed

5.3 GCIMS Generic User Accounts and Unnecessary Permissions

The audit team observed that access to GCIMS was not limited to authorized personnel.

Analysis

In PCH, GCIMS is a department-wide system used to facilitate the effective management and tracking of grants and contributions for all PCH funding programs. In GCIMS, the final step in the Gs and Cs approval process ("decide approval") is restricted to members of the Minister's Office and certain programs where the approval has been delegated (e.g. Celebrate Canada). GCIMS Services actively monitors and restricts the number of "decide approval" permission it grants in GCIMS.

The audit team conducted a review of all GCIMS user accounts with the "decide approval" security permission and found the following:

- Three users were not listed in the PCH directory and were no longer PCH employees;
- Eight users had "decide approval" permission in Programs, which did not allow the delegation of this kind of permission;
- Five User IDs were shared (i.e. generic userid) and were not uniquely identifiable; and,
- Ten users had inappropriate or potentially unnecessary permissions.

During the audit, GCIMS Services informed the audit team that they took immediate corrective action and removed inappropriate access for the majority of the accounts identified above, excepted for shared accounts.

The audit team, however, observed that even after the reported GCIMS Services corrective action, five (5) accounts with inappropriate or potentially unnecessary permissions still remained to be investigated and two (2) shared accounts remained. GCIMS Services reported that the two (2) shared accounts should remain with "decide approval" for all Programs as these accounts are employed by the Secretariat Services within the CoE, the Deputy Minister's Office and the Minister's Office. These accounts are essential in order to facilitate the smooth routing of files from Programs and regions through the CoE up to the Minister(s) for Approval and back down to the Programs.

Risk Assessment

When there is inappropriate access or potentially unnecessary security permissions granted to users, there is increased risk of unauthorized and inappropriate decisions being made in the system. In addition, the lack of a uniquely identifiable account does not provide the ability to establish individual accountability for actions performed in the database as these User IDs are shared amongst a group of many individuals, making actions in GCIMS not traceable to the original decision maker.

Recommendation

3. The Director General, Financial Management Branch, should establish a formal procedure or process to ensure on-going monitoring of user security permissions, appropriate user access and enforce the requirement that all GCIMS accounts be uniquely identifiable.

Management Response

Partially agreed

5.4 Request for Payment Selection and Review

The audit team observed an opportunity for improvement in the process used by central functions (i.e. CoE, Advisory Services and Accounting Operations and Financial Policies Directorate) to select requests for payments for review.

Analysis

At the time of the audit, all requests for payment submitted by program management (i.e. approx 5,000 to 6,000 per year) are sent by Accounting Operations to the CoE, Advisory Services, which performs a "regular quick" review. In this step, the CoE performs a check to determine if payment conditions in the contribution agreement match the payment request, and then re-submits the payment request to Accounting Operations, which processes the payment.

The audit team, however, did not find a policy or guideline which provided justification or rationale for the number of payments reviewed by the CoE, Advisory Services. In addition, the type of review did not take into consideration the degree of risk associated with the particular payment being reviewed. It was reported that starting in the fall of 2008, the CoE was to begin using statistical analysis to determine which requests for payments to select for enhanced monitoring. PCH is to use a SAP built-in auditing analysis software to sample accounts payable transactions (both pre and post payment).

Risk Assessment

The lack of a formal, risk-based approach process for selecting requests for payment for review diminishes the value and effectiveness of the control performed by the CoE, Advisory Services and potentially unjustifiably increases workload.

Recommendation

4. The Director General, Financial Management Branch, should, in selecting payments for analysis, make use of a statistical approach that allows for more extensive examination of high risk payments.

Management Response

Agreed.

5.5 GCIMS Enhancements to Strengthen Financial and Payment Controls

Within PCH, SAP is the official system of record for financial transactions while GCIMS is the departmental grants and contributions (Gs and Cs) management system, which must be used by Programs to capture all steps involved in the Gs and Cs project management process, from the time a file is first opened by an Officer to the time the file is officially closed. Currently, GCIMS and SAP operate as two separate systems with no interface for the exchange of financial information.

Analysis

At the time of the audit, GCIMS Services reported that it had been in consultation with stakeholders in the Financial Management Branch to develop business user requirements and had identified several issues and approaches for better integrating the two systems. GCIMS Services reported that it was working on a 3-year maintenance plan which will define an approach to directly interface GCIMS with SAP for the exchange of financial transactions to improve the timeliness and reliability of payment information in GCIMS and eliminate the current duplication of effort for data entry.

In addition, the audit found that Program Officers currently do not have the ability to edit/modify the payment schedule in GCIMS after ministerial approval is received; this limits the usefulness of any payment information entered into GCIMS. When new funds are made available during a funding agreement's lifecycle, the payment schedule in GCIMS cannot be modified to reflect amendments. As such, Programs track and monitor payment information outside of GCIMS, using spreadsheets and databases.

GCIMS Services reported that it was currently investigating a new process ("post-approval payment") which would help strengthen payment tracking and monitoring control in GCIMS, by allowing changes to the payment schedule to be made post ministerial approval. This new process is to be included in the 3-yr GCIMS maintenance plan mentioned above.

Risk Assessment

When two systems operate independently (GCIMS and SAP), there is increased risk of incomplete or inaccurate data being used in decision making, or duplication of effort in keeping two systems current and reconciled.

In addition, tracking and monitoring payment information outside of GCIMS using spreadsheets and databases increases the likelihood that systems that were never designed to serve as formal accounting systems are used as accounting sub ledgers and, as a result, require manipulation of data in order to prepare financial reports and expose the process to increased risks. This manual processing, which by its nature has a higher inherent risk of error, can result in unexplained differences and higher processing costs.

Recommendation

No recommendation required due to actions already taken by the auditee. OCAEE will follow up on the planned actions to ensure that execution is timely.

APPENDIX A: Audit Criteria & Conclusion

The conclusions reached for each of the audit criteria used in the audit were developed according to the following definitions.

Numerical Categorization	Conclusion on Audit Criteria	Definition of Conclusion
1	Well Controlled	- well managed, no material weaknesses noted; and - effective and sustainable.
2	Controlled	- well managed, but minor improvements are needed; and - effective and sustainable.
3	Moderate Issues	it has moderate issues requiring management focus (at least one of the following two criteria need to be met): -control weaknesses, but exposure is limited because likelihood of risk occurring is not high; -control weaknesses, but exposure is limited because impact of the risk is not high.
4	Significant Improvements Required	requires significant improvements (at least one of the following three criteria need to be met): - financial adjustments material to line item or area or to the department; or - control deficiencies represent serious exposure; or - major deficiencies in overall control structure.

The following are the audit criteria and examples of key evidence and/or observations noted which were analyzed and against which conclusions were drawn. In cases where significant improvements (4) and/or moderate issues (3) were observed, these were reported in the audit report, and the exposure risk is noted in the table below.

Criteria #	Audit Criteria	Conclusion on Audit Criteria	Examples of Key Evidence / Observation
1	Internal service standards for review and approval exist and meet management's expectations.	3	• The CoE has recently started to calculate service delivery standards; however, no formal communication or monitoring is done • Interviews, documentation review
2	Internal service standards are formally communicated to Program management.	3	• The CoE has recently determined turnaround time; however, targets are not formally communicated to clients • Interviews, review of GCIMS Services turnaround analysis
3	There is timely approval of all final recommendations by the Minister or delegated authority.	2	• The CoE has recently determined turnaround time; however, targets are not formally established and communicated to clients • Review of GCIMS Services analysis
4	Through CoE review and compliance monitoring activities, quality assurance is maintained and Program management performance improved.	3	• Tracking and reporting of significant "gaps" resulting from monitoring • No analysis found with respect to an anticipated target level for "gaps" or follow-ups
5	System/manual access in key Gs and Cs systems is limited to authorized personnel.	3	• Initially issues found with 26 accounts out of 1,071 • After reported corrective action, 2 generic accounts and 5 accounts remain with potentially excessive user permissions • Interviews, review of GCIMS user account access permissions

Criteria #	Audit Criteria	Conclusion on Audit Criteria	Examples of Key Evidence / Observation
6	Potential over/under payments are detected and corrective action is taken using a risk-based approach to review payment requests.	2	• Review limited sample of detailed request for payment analysis • Review of proposed statistical sampling approach • Interviews, documentation review
7	The vendor list is appropriately managed in order that payments are only made to approved recipients.	2	• Review of financial statement audit readiness process mappings and control matrix documentation • Reviewed listing of Gs and Cs payments for fiscal years 2006-07 and 2007-08 • Interviews, documentation review
8	Those who approve claims do not also approve payments.	1	• Review of financial statement audit readiness process mappings and control matrix documentation • Review of a small sample of payments processed centrally • Review of segregation of duties report of critical combinations
9	Payments are recorded accurately in SAP in the proper period.	1	• Review of financial statement audit readiness process mappings and control matrix documentation • Review of a small sample of payments made in last 2 weeks of fiscal year